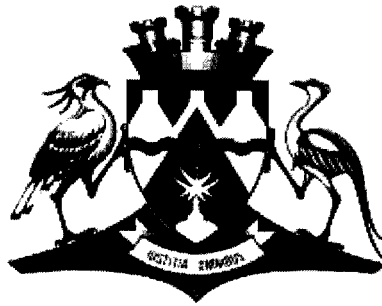


**PIXLEY KA SEME
DISTRICT MUNICIPALITY**



CONTINGENT LIABILITY POLICY

PIXLEY KA SEME DISTRICT MUNICIPAL CONTINGENT LIABILITY POLICY

Adoption : 2014/03/28

Review : 2018/05/28

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1. DECLARATION OF INTENT

At its broadest level, the Municipal Finance Management Act (MFMA) endeavours *“to secure sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities by establishing norms and standards and other requirements”*.

In particular, Chapter 12 of the MFMA places the onus on the Municipality to take responsibility for the preparation of an annual report in accordance with this chapter. More specifically this Chapter provides guidance on the preparation of financial statements, disclosures on intergovernmental and other allocations and other compulsory disclosures

2. OBJECTIVE OF THE POLICY

The objective of the policy document is to clearly define the responsibilities of the Pixley Ka Seme District Municipality in terms of the Municipal Finance Management Act with respect to the disclosure of both approved and contracted for and approved but not yet contracted for commitments in the Annual Financial Statements. This policy document addresses the following areas:

- The definition of a contingent liability;
- The accounting policy with respect to contingent liability;
- Guidance on the identification and accounting treatment of contingent liability; and
- Guidance on the disclosure requirements for contingent liabilities.

3. TERMINOLOGY AND DEFINITIONS

In this policy, unless the context indicates otherwise, a word or expression to which a meaning has been assigned has the same meaning, and-

“Annual report” in relation to a municipality or municipal entity, means an annual report contemplated in Section 121 of the MFMA.

“Constructive Obligation” a constructive obligation is an obligation that derives from an entity’s actions where:

- By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

“Contingent Liability” a contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Municipality; or

- a contingent liability is a present obligation that arises from past events but is not recognised because

- it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation or
- the amount of the obligation cannot be measured with sufficient reliability.

“Debt” means –

- a monetary liability or obligation created by a financing agreement, note, debenture, bond or overdraft, or by the issuance of municipal debt instruments; or
- a contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

“Financial Statements” in relation to municipality or municipal entity, means statements consisting of at least –

- a statement of financial position;
- a statement of financial performance;
- a cash-flow statement;
- any other statements that may be prescribed; and
- any notes to these statements.

“Financial Year” means a year ending 30 June.

4. SCOPE OF APPLICATION

From a responsibility perspective, this policy is relevant to all employees of the Municipality, whether full-time or part-time. It is, however, specifically applicable to the Council, Accounting Officer, Chief Financial Officer and Senior Managers whether full-time or part-time. In particular, the duly appointed Directorate and responsibility managers have significant roles in:

- Identifying events, which meet the recognition criteria and definition of a contingent liability for disclosure in the Annual Financial Statements;
- Determining the Rand value of the contingent liability to be disclosed on the Annual Financial Statements.

5. GOVERNING PRESCRIPTS

This Policy has been formulated in terms of the Municipal Finance Management Act, 2003 (Act 56 of 2003) and the Generally Recognised Accounting Practice on Presentation of Financial Statements (GRAP 1) and the Generally Recognised Accounting Practice Statement on Provisions, Contingent Liabilities and Contingent Assets (GRAP 19).

Legal framework

This policy will be implemented within the legal framework of the relevant national legislation outlined hereunder.

- The Municipal Finance Management Act, 2003 (Act 56 of 2003) Sections 121 – 125.

6. ACCOUNTING POLICY

Contingent liabilities are not recognised in the statement of financial position as a liability or as expenditure in the statement of financial performance but are included in the disclosure notes to the financial statements.

7. GUIDING PRINCIPLES

This policy supports the following principles:

- To secure the sound and sustainable management of the financial affairs of the municipalities and other institutions in the local sphere of government;
- To establish treasury norms and standards for the local sphere of government;
- Ensuring transparency, accountability and appropriate lines of responsibility in the fiscal and financial affairs of municipalities and municipal entities; and
- The management of the municipality's revenues, expenditures, assets and liabilities and the handling of their financial dealings.

Paragraph 32 and 34 - 36 of GRAP 19 dealing with the recognition of a contingent liability states the following:

- Paragraph 32 – In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability.
- Paragraph 34 – A contingent liability is disclosed, as required by paragraph .110, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.
- Paragraph 35 – Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. For example, in the case of joint venture debt, that part of the obligation that is not to be met by other joint venture participants is treated as a contingent liability. The entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits or service potential is probable, except in the rare circumstances where no reliable estimate can be made.
- Paragraph 36 – Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs, except in the extremely rare circumstances where no reliable estimate can be made. For example, a municipality may have breached an environmental law but it remains unclear whether any damage was caused to the environment. Where, subsequently, it becomes clear that damage was caused and remediation will be required, the entity would recognise a provision because an outflow of economic benefits is now probable.

Paragraph 110 of GRAP 19 dealing with the disclosure of contingent liabilities states the following:

- Unless the possibility of any outflow in settlement is remote, an entity shall disclose for
- each class of contingent liability at the reporting date a brief description of the nature of the
- contingent liability and where practicable:
 - ✓ an estimate of its financial effect, measured under paragraphs .49 to .65;
 - ✓ an indication of the uncertainties relating to the amount of timing of any outflow; and
 - ✓ the possibility of any reimbursement.

Paragraph 121 of GRAP 1 dealing with the Presentation of Financial Statements states the following:

Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:

- (a) A statement of compliance with Standards of GRAP (see paragraph .19);
- (b) A summary of significant accounting policies applied (see paragraph .124);
- (c) Supporting information for items presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets or cash flow statement in order in which each line item and each financial statement is presented; and
- (d) Other disclosures, including:
 - (i) Contingent liabilities (see the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets*) and unrecognised contractual commitments; and
 - (ii) Non-financial disclosures, e.g. the entity's financial risk management objectives and policies (see the Standard of GRAP on *Financial Instruments: Disclosure and Presentation*).

Section 122 (3) of the Municipal Finance Management Act 56 of 2003 states that "Both annual financial statements and consolidated annual financial statements must be prepared in accordance with generally recognised accounting practice in terms of Section 91(1)(b) of the Public Finance Management Act".

Section 125(2)(c) of the Municipal Finance Management Act 56 of 2003 states that "The notes to the financial statements of a municipality must include particulars of any contingent liabilities of the municipality or entity as at the end of the financial year".

7.1 Guiding principles: Determining whether a contingent liability exists at reporting date

A liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow on resources embodying economic benefits or service potential.

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There are two types of obligations:

- A legal obligation is an obligation that derives from a contract (through its explicit or implicit terms, legislation or other operation of law).
- A constructive obligation is an obligation that derives from an entity's actions that have created a valid expectation on the part of other parties that it will discharge those responsibilities. This valid expectation could arise as a result of an established pattern of past practice, published policies or sufficiently specific current statement indicating that the entity will accept certain responsibilities.

To understand a contingent liability it is important to first understand the concept of a liability. In an accrual environment, a liability is recognised when it is either **virtually certain or probable (more likely than not)** that the entity has a present obligation, the settlement of which will require an outflow of economic benefits or service potential from the entity. A contingent liability is disclosed when it is **possible** that economic benefits will flow from the entity, or when an outflow of economic benefits or service potential is probable but cannot be measured reliably.

This concept is illustrated in the table below:

Liabilities	Outflow of economic benefits/service potential		
	Probable (more likely than not)	Possible	Remote
Reliable estimate	Liability (consider including in the note on provisions)	Contingent liability (disclose)	Contingent liability (do nothing)
Not reliable estimate	Contingent liability (disclose)	Contingent liability (disclose)	Contingent liability (do nothing)

The type of disclosures required in the note on contingent liabilities is discussed in the section 7.2 below.

7.2 Guiding principles: Disclosure

Claims

The amount that must be disclosed in the disclosure note to the annual financial statements of the Municipality is the estimated settlement value of claims instituted against the Municipality as at 30 June. The claim will only be settled when either the court decides that the Municipality is liable or the Municipality accepts the liability, both of which are unknown. Civil claims against the Municipality that have not been settled (by a court order or mutually between the parties) must be included in **contingent liabilities**.

Claims are normally overstated. The amount disclosed is not necessarily the claim amount, but rather the amount determined as the most likely amount that the court will settle on. "Most likely" must be determined by a qualified legal person (such as a lawyer) or from Municipal history.

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Where final settlement was reached and payment was made

These payments will be expensed against the vote. Where final settlement was reached but payment is outstanding as at 30 June it represents a provision and should be disclosed as such in a disclosure note.

7.3 Guiding principles – required disclosure note for commitments

The following serves as an illustrative example of the required disclosure note for contingent liabilities:

Contingent Liabilities

The municipality is at this stage involved in a legal dispute with Musscle Construction regarding the Ouboks Housing Project in Colesberg. 339 021.69

The possible liability will be R339 021.69 (this amount is subject to interest @ 15.5% p.a.)

8. COMMENCEMENT

This Policy takes effect on 01 July 2018.

EXECUTIVE MAYOR :



DATE POLICY APPROVED :

28 March 2014

RESOLUTION :

R 2014 – 03 – 28 (9.9)

DATE POLICY REVIEWED :

28 May 2018

RESOLUTION :

R 2018 – 05 – 28 (9.6)